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Editors' Summary

The fifth annual conference of the India Policy Forum was held on July 15 and 16 of 2008 in New Delhi. This issue of the journal contains the papers and discussion presented at the conference. A total of five papers were presented. The first paper examines the growth of private schools in India and their influence on school quality. It is an extension of recent issues of this journal that have evaluated the performance of India's education system. The second paper addresses a major question of why the growth of manufacturing output and employment in India has been disappointingly low. The final three papers share a common focus on India's external financial relations. The third paper analyzes the process of capital account liberalization and the integration of India's financial institutions into the global financial system. The fourth paper measures the evolution of prices in the nontradable and tradable sectors of the Indian economy and seeks explanations for the rise in the relative price of nontradables. The last paper addresses the issue of the adequacy of India's current foreign exchange reserves.

Although the growth of private schooling in India is ubiquitous even in rural areas, the contours and implications of this change remain poorly understood, partially due to data limitations. Official statistics often underestimate private school enrollment and our understanding of the effectiveness of private education in India is also limited. If we assume that parents know what is best for their children and that what is beneficial privately is also beneficial socially, their decision progressively to opt for private schools would suggest the superiority of the latter over public schools.

In their paper, Sonalde Desai, Amaresh Dubey, Reeve Vanneman, and Rukmini Banerji point out, however, that this is not a foregone conclusion. The vast body of research on school quality, especially that relating to the United States, suggests that much of the observed difference in school outcomes results from differences in parental background and levels of parental involvement with children going to different schools. In the Indian context, one runs the additional risk that many private schools are poorly endowed with resources, unrecognized (lack accreditation), and have untrained teachers. A proper empirical examination is essential to arrive at an informed assessment.

The authors use data generated from a new survey, the India Human Development Survey 2005 (IHDS), jointly conducted by researchers from

the University of Maryland and the National Council of Applied Economic Research. These data allow them to explore some of the links between private school growth and school quality in India. They begin by providing a description of public and private schools in India as well as some of the considerations that guide parents in selecting private schools. They then examine whether private school enrollment is associated with superior student performance and whether this relationship is concentrated in certain sections of the population.

The IHDS data show considerably higher private school enrollment, particularly in rural areas, than documented in other studies. The authors place private school enrollment (including in schools receiving grants-in-aid from the government) among children aged 6–14 years at 58 percent in urban and 24 percent in rural areas. Private school enrollment is particularly high in India's most populous state, Uttar Pradesh. In terms of outcomes, based on specially designed reading and arithmetic tests administered to children aged 8–11 years, those in private schools exhibit better reading and basic arithmetic skills than their counterparts in government schools.

But since these children also come from higher income households and have parents who are better educated and more motivated to invest in their children's education, it is important to control for selectivity bias. The paper utilizes a variety of techniques (including multivariate regression, switching regression, and family fixed effects) to examine the relationship between private school enrollment and children's reading and arithmetic skills. While no model is able to completely eliminate possible biases—there is a different source of bias left in each case—taken together, the results strongly indicate that private school enrollment is associated with higher achievements in reading and arithmetic skills. The magnitude of the gain from private school enrollment varies from one-fourth to one-third standard deviation of the scores.

The paper also distinguishes the relative magnitudes of the benefits from private schooling to children with rich versus poor economic backgrounds. It finds that the benefits to private school enrollment for children from lower economic strata are far greater than those for children from upper economic strata; at upper income levels, the difference between private and government school narrows considerably. This seems plausible since at upper income levels, students are likely to have better access to alternative educational resources including well-educated parents.

While the results of the paper point to positive benefits from private schools, especially for the underprivileged, the authors emphasize that their analysis does not imply that private schooling is the elixir that will cure the

woes of primary education for children from poor families. They argue that both empirical results based on the IHDS data and theoretical considerations point to the need for caution.

Empirically, the paper finds that while private school students perform better than their counterparts in government schools, these effects are modest in comparison to other factors influencing the outcomes. For example, the results show substantial inter-state variation in the scores of both government and private school students. Controlling for parental characteristics, government school students in states as diverse as Kerala, Himachal Pradesh, Chhattisgarh, and West Bengal perform at a higher level than private school students in many other states. More importantly, the private school advantage seems to be concentrated in states such as Bihar, Uttar Pradesh, Uttarakhand (formerly Uttranchal), and Madhya Pradesh—states known for poorly functioning public institutions as well as high rates of poverty or low per capita incomes.

These results suggest that before a blanket embrace of private schooling, it may be worthwhile to understand why some government schools function well and others do not. Blaming teacher absence is superficially appealing, but theoretical considerations suggest that the complete story may be more complex. If the classroom environment in private schools is favorably impacted by the demands made by paying middle-class parents, a voucher program that brings a large number of poorer parents to the schools may dilute this effect. But this argument would seem to be undermined by the fact that the authors themselves find the private school effect to be significant in poor states with many students coming from poor families.

Nevertheless, the authors are correct in noting that it will be useful to further examine the processes that give rise to different classroom environments as between government and private schools before jumping to wholesale voucher programs leading to privatization of education. We must know, for example, whether children from poor households in private schools benefit because their parents are able to prevent teachers from resorting to physical punishment. And if so, would this benefit be diluted when vouchers rather than parents pay for the tuition? Can we devise mechanisms to ensure that government school teachers do not resort to discriminatory behavior when dealing with students from poor families? To date, the discourse on the benefits of private schooling in a developing country context has focused on teacher absence, lack of accountability, and lower costs of private schooling. While these are important issues, perhaps future research could try to shed additional light on other processes that establish different environments in private and public schools.

The promotion of manufacturing, particularly for export, has been a key pillar of the growth strategy employed by many successful developing countries, especially those with abundant labor. India's recent experience is puzzling on two accounts. While India's economy has grown rapidly over the last two decades the growth momentum has not been based on manufacturing. Rather the main contributor to growth has been the services sector. Second, the relatively lackluster performance of Indian manufacturing cannot be ascribed to a lack of policy initiatives. India introduced substantial product market reforms in its manufacturing sector starting in the mid-1980s, but the sector has never taken off as it did in other high-growth countries. Moreover, insofar as subsectors within manufacturing have performed well, these have been the relatively capital or skill-intensive industries, not the labor-intensive ones as would be expected for a labor abundant country like India.

One of the main components of reforms in India was the liberalization of the industrial licensing regime, or "delicensing." Under the Industries Development and Regulation Act of 1951, every investor over a very small size needed to obtain a license before establishing an industrial plant, adding a new product line to an existing plant, substantially expanding output, or changing a plant's location.

Over time, many economists and policymakers began to view the licensing regime as generating inefficiencies and rigidities that were holding back Indian industry. The process of delicensing started in 1985 with the dismantling of industrial licensing requirements for a group of manufacturing industries. Delicensing reforms accelerated in 1991, and by the late 1990s, virtually all industries had been delicensed. Large payoffs were expected in the form of higher growth and employment generation with this policy reform.

However, the payoffs to date have been limited. It could be argued that a lag between the announcement and implementation of the policy, and also a lag between implementation and the payoffs may be responsible. However, as many as 20 years have passed since the first batch of industries was delicensed, and the last batch of industries was delicensed almost a decade ago; the view that payoffs would occur with a lag is no longer easy to sustain.

What then could be the reasons for the rather lackluster performance of the industrial sector? The following factors are usually cited: (a) strict labor laws have hindered growth, especially of labor-intensive industries; (b) infrastructure bottlenecks have prevented industries from taking advantage of the reforms; and (c) credit constraints due to weaknesses in the financial sector may be holding back small- and medium-sized firms from expanding.

More recently, two other factors have also been raised. First, it has been pointed out that the evolution of Indian industry may be influenced by path dependence or hysteresis so that despite the reforms of the mid-1980s and the early 1990s the relative profitability of capital and skill-intensive activities remains higher than that of labor-intensive activities. Second, the major reform initiatives undertaken so far—focused mainly on product market reforms—have been national ones. However, the working of product markets in a federal democracy such as India is influenced not only by regulations enacted by the Central Government, but also by those enacted by individual state governments. Moreover, much of the authority on administration and enforcement of regulation also rests with state governments. Accordingly, it has been pointed out that regulatory and administrative bottlenecks at the state level may be blunting the impact of reforms undertaken at the central level.

Using the Annual Survey of Industries (ASI) data at the three-digit level for major Indian states over the period 1980–2004, the paper by Gupta, Hasan, and Kumar analyzes the effects of delicensing reforms on the performance of what in India is called registered manufacturing. (The portion of manufacturing in the so-called unorganized sector is not covered by the ASI data and is therefore not analyzed in the paper; however, this component was also unlikely to have been affected by the licensing controls when these were in effect.) The paper utilizes variations in industry and state characteristics in order to identify how factors such as labor regulations, product market regulations, availability of physical infrastructure, and financial sector development may have influenced the impact of delicensing on industrial performance.

The main findings of the paper are as follows:

1. The impact of delicensing has been highly uneven across industries. Industries that are labor intensive, use unskilled labor, depend on infrastructure, or are energy dependent have experienced smaller gains from reforms.
2. Regulation at the state level matters. States with less competitive product market regulations have experienced slower growth in the industrial sector post-delicensing, as compared to states with competitive product market regulations. States with relatively inflexible labor regulations experience slower growth of labor-intensive industries and slower employment growth.
3. Infrastructure availability and financial sector development are important determinants of the benefits that accrued to states from reforms.

If supportive regulatory conditions prevailed and infrastructure availability allowed it, businesses responded by expanding their capacity and grew; thus hysteresis does not seem to matter.

The authors acknowledge that their approach is subject to a few caveats. Several other major reforms have been introduced that impact Indian manufacturing, including reductions in barriers to trade and the dismantling of the policy of reserving particular industries for production by small-scale enterprises. These are not systematically examined and might interact with the impact of delicensing. Second, the neglect of the unorganized sector noted above means that the interactions between the “registered” and the “unorganized” sectors in adjusting to policy change is not systematically explored. Finally, regulations can affect firms and industries in many different ways. For example, they may create incentives for firms to operate in the informal sector, stay relatively small, or adopt particular types of techniques. While the analysis of aggregate data can shed (indirect) light on some of these effects, a more complete analysis would require the use of a micro-based approach utilizing plant-level data.

The authors conclude that the agenda of reforms to promote manufacturing is not yet complete. Areas for additional action include further reform of labor market regulations; improvement of the business environment; provision of infrastructure and further development of the financial sector. In addition, in a federal democracy like India, reforms at the Center (especially those related to labor) need to be complemented by reforms at the state level.

Capital account liberalization remains a highly contentious issue. Proponents argue that rising cross-border flows of financial capital allow for a more efficient allocation of financial resources across countries and also permit countries to share their country-specific income risk more efficiently. Detractors have blamed capital account liberalization as being the root cause of the financial crises experienced by many emerging market countries. Their case has been strengthened by the lack of clear evidence of the presumed benefits of financial globalization. This debate has again become topical as many emerging market economies and even some low-income countries are coping with volatile capital inflows, with major economies like China and India contemplating further opening of their capital accounts.

A common argument in the literature in favor of openness from the viewpoint of the developing economies has been that access to foreign capital helps increase domestic investment beyond domestic saving. The recent literature has revived another older argument emphasizing the indirect benefits of openness to foreign capital, including the development of domestic financial

markets, enhanced discipline on macroeconomic policies, and improvements in corporate governance.

In his paper, “Some New Perspectives on India’s Approach to Capital Account Liberalization,” Eswar S. Prasad argues that a major complication in considering capital account convertibility is that economies with weak initial conditions in certain dimensions experience worse outcomes from their integration into international financial markets in terms of both lower benefits and higher risks. For countries below these “threshold” conditions, the benefit–risk tradeoff becomes complicated and a one-shot approach to capital account liberalization may be risky and counter-productive. This perspective points to a difficult tension faced by low and middle-income countries that want to use financial openness as a catalyst for the indirect benefits mentioned above.

The author, nevertheless, maintains that the practical reality is that emerging market countries are being forced to adapt to rising financial globalization. In his view, capital controls are being rendered increasingly ineffective by the rising sophistication of international investors, the sheer quantity of money flowing across national borders, and the increasing number of channels (especially expanding trade flows) for the evasion of these controls. Hence, concludes the author, emerging market economies like China and India are perforce grappling with the new realities of financial globalization, wherein capital controls are losing their potency as a policy instrument (or at least as an instrument that creates more room for monetary and other macro policies). Against this background, the author provides a critical analysis of India’s approach to capital account liberalization through the lens of the promised indirect benefits from such liberalization. In recent years, the Reserve Bank of India (RBI) has taken what it calls a calibrated approach to capital account liberalization, with certain types of flows and particular classes of economic agents being prioritized in the process of liberalization. The result of these policies is that, in terms of overall *de facto* financial integration, India has come a long way, experiencing significant volumes of inflows and outflows. Although foreign investment flows crossed 6 percent of GDP in 2007–08, in the author’s view the flows are modest, placing India at the low end of the distribution of *de facto* financial integration measures in an international comparison across emerging market economies.

The RBI’s cautious and calibrated approach to capital account liberalization has resulted in a preponderance of FDI and portfolio liabilities in India’s stock of gross external liabilities. The author agrees that this is a favorable outcome in terms of improving the benefit–risk tradeoff of financial openness and has reduced India’s vulnerability to balance of payments crises. But he goes

on to argue that the limited degree of openness has, nevertheless, hindered the indirect benefits that may accrue from financial integration, particularly in terms of broad financial sector development.

Against the backdrop of recent global financial turmoil, the author sees merit in a high level of caution in further opening the capital account. He states, however, that excessive caution may be holding back financial sector reforms and reducing the independence and effectiveness of monetary policy. He goes on to argue that increasing *de facto* openness of the capital account implies that maintaining capital controls perpetuates some distortions without the actual benefit in terms of reducing inflows. Flows of different forms are ultimately fungible and it is increasingly difficult, given the rising sophistication of investors and financial markets, to bottle up specific types of flows. In the author's view, rising *de facto* openness in tandem with *de jure* controls may lead to the worst combination of outcomes—new complications to domestic macroeconomic management from volatile capital flows with far fewer indirect benefits from financial openness.

The author takes the view that a more reasonable policy approach would be to accept rising financial openness as a reality and to manage, rather than resist (or even try to reverse), the process of fully liberalizing capital account transactions. Dealing with and benefiting from the reality of an open capital account will require improvements in other policies—especially in monetary, fiscal, and financial sector regulations. This approach could in fact substantially improve the indirect benefits to be gleaned from integration into international financial markets.

In terms of specific steps, the author suggests that this may be a good time to allow foreign investors to invest in government bonds as an instrument of improving the liquidity and depth of this market. A deep and well-functioning government bond market can serve as a benchmark for pricing corporate bonds, which could in turn allow that market to develop. By providing an additional source of debt financing, it would create some room for the government to reduce the financing burden it currently imposes on banks through the statutory liquidity ratio—the requirement that banks hold a certain portion of their deposits in government bonds.

The author also recommends an “opportunistic approach” to liberalization whereby outflows are liberalized during a period of surging inflows. He suggests that if undertaken in a controlled manner, it could generate a variety of collateral benefits—sterilization of inflows, securities market development, and international portfolio diversification for households. The RBI has recently adopted such an approach by raising ceilings on external commercial borrowings in order to compensate for capital outflows. According to the

author, these are steps in the right direction. But one potential problem he sees is that when taken in isolation rather than as part of a broader and well-articulated capital account liberalization agenda, these measures are subject to reversal and unlikely to be very productive.

Despite this enthusiasm for capital account liberalization, the author goes on to suggest that none of this implies that the remaining capital controls should be dropped at one fell swoop. What it does imply is that there are some subtle risks and welfare consequences that can arise from holding monetary and exchange rate policies as well as financial sector reforms hostage to the notion that the capital account should be kept relatively restricted for as long as possible. It may seem reasonable to maintain whatever capital controls still exist in order to get at least some protection from the vagaries of international capital flows. However, in the author's view, not only this is an unrealistic proposition, it could detract from many of the potential indirect benefits of financial integration. He sees steady progress toward a more open capital account as the most pragmatic policy strategy for India.

India's rapidly evolving economic landscape during the past two decades has elicited broad discussion of how changing economic factors will influence the future of India's growth and prosperity. Often overlooked in the discussion are the effects of India's changing economic structure on relative price dynamics, which have consequential effects on the allocation of resources in the economy. A host of recent developments would likely induce a change in relative prices, including the shift in economic policies beginning in 1991, the acceleration in economic growth, a rapid increase in exports, and rising per capita incomes and productivity growth. Taken together, these factors amount to the "catch-up" process that typically leads to an increase in the relative price of nontradables in developing economies.

In their paper, Renu Kohli and Sudip Mohapatra trace relative price developments in a two-sector, two-good (tradable and nontradable) framework for the Indian economy over the period 1980–2006. In line with their *a priori* expectations, the ratio of nontradable to tradable prices, also called the internal real exchange rate, rises consistently over the past one-and-a-half decades. Their empirical analysis confirms that this rise, or real appreciation, is driven by both demand and supply factors. A later section uses the results of the study to illuminate the evolution of past macroeconomic policies. Finally, using India's recent robust economic performance as a guide, the paper concludes with a discussion on an appropriate macroeconomic policy mix for the future.

The authors construct the relative price of nontradables from the national accounts statistics using the degree of participation in trade as a criterion

for classifying the economy into traded and nontraded sectors; the tradable–nontradable price series are derived as respective deflators for the two sectors. They find that the tradable and nontradable sectors are characterized by divergent inflation rates with the relative price of nontradables accelerating after 1991; on average, the difference exceeds 1 percentage point per year during 1991–2006. There are two competing explanations for such a divergent acceleration in prices: (a) the Balassa–Samuelson hypothesis posits that real exchange rates tend to appreciate as countries develop and (b) other demand-side explanations originate from changes in government spending and/or a shift in consumer preferences toward services (nontradable) as incomes rise. The preliminary analysis presented in the paper indicates a role for both factors in explaining the real exchange rate appreciation. A puzzle posed by the data, however, is the increase in the relative price of nontradables in conjunction with an expansion of the tradable sector, which suggests an offsetting role might have been played by economic reforms like import liberalization and exchange rate correction, leading to the emergence of new tradables through an increase in competitiveness.

The paper examines the determinants of this divergence in an integrated framework, exploring the role of both demand and supply side determinants. The relative price of nontradables is modeled as a function of the labor productivity growth gap between the tradable and nontradable sectors, real government expenditure as a share of gross domestic product, real per capita income, and a measure of import tariffs. The labor productivity growth gap and the import tariff rates capture the supply-side influences due to technological change (the Balassa–Samuelson effect) and the impact of trade liberalization, which accelerated after 1991. The fiscal and income growth variables summarize the demand side impact upon relative prices. The regression results reveal a significant influence of both demand and supply factors. A percentage point rise in the relative price of nontradables is associated with a 5 percent increase in the labor productivity growth gap, a 4 percent increase in per capita income growth, and a 3 percent increase in fiscal growth; the estimated impact of a fall in import prices upon the relative nontradables' inflation rate is 0.04. The results are robust to a number of sensitivity checks, including different estimation methods, stability, specification, omission, and inclusion of variables as well as alternate definitions of the variables.

A decomposition of the relative price change over the sample period indicates that demand factors accounted for almost three-fourths of the average relative price increase over the sample period. In contrast, the supply-side influence stemming from the labor productivity growth differential between

the two sectors accounted for only 35 percent of the mean of the dependent variable. Noting the rapid decline in import tariffs after 1991, the authors argue that this result underscores the role of convergence in tradable prices and its contribution to the divergence in sectoral inflation rates in liberalizing economies.

Kohli and Mohapatra link their results to macroeconomic policy by tracing the past evolution of exchange rate and fiscal policies in India. They argue that the fiscal expansion of the 1980s ending in the 1991 crisis led to a rise in the inflation rate of the nontradable sector, while the exchange rate policy favored steady depreciation in order to retain competitiveness and boost growth. Noting India's recent and potential economic performance, its buoyant exports, and strong per capita income growth, they observe that the pressures upon real exchange rate appreciation, internal as well as external, are likely to continue—and indeed, accelerate—in the future. Under the circumstances, an appropriate macroeconomic policy mix would be to continue with the gradual increase in exchange rate flexibility so as to absorb the equilibrium shifts in the economy. This could be complemented with fiscal consolidation to offset competitiveness losses arising from the nominal and real exchange rate appreciation.

Finally, the paper raises a number of critical data issues, not the least of which is the absence of a services price index in India. The implicit price series developed in the paper strongly suggests an understatement of generalized inflation through the current inflation indicator, the wholesale price index (WPI), which can be misleading. It also identifies gaps in the data on sectoral employment shares, emphasizing the need for sufficiently disaggregated information to enable fruitful analysis and informed policy-making.

The Asian financial crisis of 1997–98 served as a startling revelation to emerging economies of the drawbacks of financial integration. Neither the International Monetary Fund nor reliance on more flexible exchange rate regimes succeeded in preventing—or indeed, adequately combating—such a systemic crisis. Moreover, even countries practicing sound macroeconomic policies realized they were not immune to such crises as they can be hit by contagion and financial panic from other countries, regardless of their proximity. As a result, many countries have decided that they need to protect themselves against a speculative currency attack, and further, that the key to self-protection is the accumulation of substantial holdings of liquid foreign exchange. Over the past decade, developing countries, and particularly those in East and South Asia, have greatly expanded their foreign currency reserves. By the middle of 2008, the reserves of China, South Korea, Russia, and

India alone amounted to over US\$2.85 trillion. In the case of India, reserve accumulation has increased five-fold since 2001-02.

The security that results from high reserves does come at a price, however. The magnitude of reserves being held combined with the fact that most reserves are held as low-yield government bonds suggests that the opportunity cost of reserve holdings can be substantial. In his paper, Abhijit Sen Gupta employs a new empirical methodology to evaluate the factors influencing the demand for international reserves in emerging markets, and he estimates the costs incurred in the process for India in particular. Sen Gupta argues that the traditional analysis of the costs of reserve holdings, which considers a single adequacy measure (namely, import cover), does not reflect the multitude of factors influencing demand for international reserves in a financially integrated world. In addition to the desire to meet potential imbalances in current account financing, a central bank may also hold reserves to defuse a potential speculative run on its currency or to cover its short-term debt obligations.

The author first introduces a simple empirical model to highlight the principal determinants of reserve holding in emerging countries. Using the results of this model, one can create an “international norm” of reserve holding, and thereby calculate a measure of “excess reserves” which is the difference between actual reserve holdings and this international norm. Next, Sen Gupta provides a brief discussion of the history of reserve accumulation in India. As the bulk of India’s reserves are held in the form of highly liquid securities or deposits with foreign central banks and international organizations, the real return on these assets in recent years has been largely negative. In the final section, Sen Gupta estimates the cost of holding reserves in India by considering three alternative uses of the resources currently held in excess of the international norm described earlier.

The empirical section of the paper employs a sample of 167 countries over the period 1980-2005 and a regression framework that identifies the principal determinants of cross-country variation in the level of international reserves. In this context, reserves are defined as total reserves minus the country’s holdings of gold. The dependent variable is this measure of reserves scaled by Gross Domestic Product (GDP). The results of this regression accord well with the *a priori* expectations. The log of per capita GDP and a proxy for trade openness (measured as the ratio of imports to GDP) both record positive and significant coefficients for reserve holding, implying that richer countries and more open countries tend to have higher reserves. In addition, the regression results reveal that countries with less flexible

exchange rate regimes and more capital account openness tend to accumulate greater reserves.

Next, the author uses the above framework for the period 1998–2005 to predict the demand for international reserves for various emerging countries. The difference between actual reserves and the reserve level predicted by the equation is interpreted as a measure of excess reserves. As illustrations of his results, Sen Gupta finds that by 2005, Indonesia, Philippines, and Argentina had reserves close to the amount predicted by the model, while Brazil's reserve accumulation fell significantly short of the predicted value. In contrast, China, India, Korea, Russia, and Malaysia all exhibit significantly more reserves than what could be interpreted as an "international norm."

In his discussion of India's experience in reserve accumulation, Sen Gupta identifies several distinct episodes of significant reserve buildup in India: April 1993 to July 1995, November 2001 to May 2004, and November 2006 to February 2008. These three episodes account for more than US\$ 220 billion worth of India's current stock of reserve accumulation of US\$ 300 billion. In each of these episodes, the author discusses the role that both the government and the Reserve Bank of India (RBI) played in the decision to accumulate reserves.

Sen Gupta estimates that by the end of 2007, India had more than US\$ 58 billion of excess reserves. In order to impute the costs of holding these excess reserves, he considers three alternative uses of the resources: financing physical investment, reducing the private sector's external commercial borrowing, and lowering public sector debt. The cost is substantial across all specifications, both in terms of actual income foregone and as a percentage of GDP. The author estimates the annual cost of keeping excess reserves in the form of low-yielding bonds rather than employing the resources to increase the physical capital of the economy to be approximately 1.6 percent of GDP. Alternatively, if the resources were instead used to reduce private sector external commercial borrowing or public sector debt, India could gain more than 0.23 percent of GDP.